**INTEGRATED CLINICAL SYSTEMS, INC.
(AMERICAN MONITOR
CORPORATION)**

**VABCA-3745 &
CONTRACT NO. V589P-1123 3914-3917**

**VA MEDICAL CENTER
KANSAS CITY, MISSOURI**

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OPINION BY ADMINISTRATIVE JUDGE McMICHAEL

These appeals arise from the termination for convenience of a lease of two blood chemical "Perspective Analyzers" by the Department of Veterans Affairs (VA or Government) Medical Center in Kansas City, Missouri. Integrated Clinical Systems, Inc. is the successor-in-interest to AM Diagnostics, Inc. which was the successor-in-interest to American Monitor Corporation (AMC or Contractor) who leased the Analyzers to the VA. (Exh. A-34) AMC seeks a total of $444,036.88 from the VA for termination for convenience settlement costs and equitable adjustments to the Contract.

In its appeal from a denial of its termination for convenience settlement claim (VABCA-3745), AMC seeks $295,996.88. A substantial part of the dispute turns on whether the Contractor can recover its "unexpired lease expenses" resulting from a five year "sale-leaseback" arrangement it entered into with a financing corporation concerning the two Analyzers furnished to the VA. The Contractor argues alternatively that such costs are recoverable as allowable settlement costs under the Federal Acquisition Regulations (FAR), or are recoverable under the theory of *quantum valebant* on an implied-in-fact contract. That is, although the contract terms clearly establish a one year lease with four one-year renewal options, AMC maintains that the VA, in fact, "guaranteed" a five year contract.

In VABCA Nos. 3914-16, AMC also seeks to recover a total of $148,040 for constructive changes to the contract during performance including additional training ($119,000), maintenance ($17,000), and "correlation study" assistance ($11,848). A fifth appeal involving a $331,250 claim for lost profits arising from a breach of contract claim (VABCA-3917) has been withdrawn.

In response, the Government denies that its obligations extended for any more than one year under the terms of the Contract, and that VA officials ever "guaranteed" the four option years. It also argues that any training, maintenance or correlation study assistance was either provided by AMC pursuant to contract requirements or as a "volunteer" and that the VA was never notified that the Contractor considered such work as beyond the requirements of the Contract.

The Record consists of the Appeal File (R4, tabs 1-39) as supplemented, together with exhibits submitted by the Government (Exhs. G-1 to G-11) and the Appellant (Exhs. A-1 to A-42), and a transcript of a hearing held in Kansas City, Missouri (Tr. 1-476) by the Board's Hearing Examiner. Both parties filed thorough and comprehensive briefs.

FINDINGS OF FACT

Sometime in July 1987, Dr. John Dear, Director of Clinical Biochemistry at the VA Medical Center (VAMC), Kansas City, Missouri, attended a trade show in San Francisco and became interested in the possibility of replacing his current blood chemistry analyzer with a Perspective Analyzer manufactured by AMC. (Tr. 183) Responding to this interest, AMC sales representative Dale Thomas visited Dr. Dear in Kansas City, sometime in late August or early September, to assess his needs and to "give him a cost per test" and the "equipment lease cost . . . based on the capital equipment for one analyzer times the lease rate for five years." (Tr. 184-85) On September 4, 1987, AMC sent a written "Lease Quotation" to Dr. Dear for one Perspective Analyzer for an "Initial Term" of 60 months at a monthly payment of $2,654. (Exh. G-2) According to Thomas, Dr. Dear was "very happy with the cost per test and the numbers . . . given him on acquiring the equipment." (Tr. 185) Thereafter, Dr. Dear visited the Contractor's facility in Indianapolis, Indiana in October and, according to Dale Thomas, concluded that "he would now like to get 2 Perspective [Analyzers]." (R4, tab 16)

Periodic discussions ensued between Thomas and Dr. Dear until March 30, 1988, when the Kansas City VAMC issued a Solicitation (RFP 589-32-88) for "Lease of Chemistry Analyzers" for its Laboratory Service. (R4, tab 1) Under this negotiated RFP, the VA sought "two chemistry analyzers per section C on a rental basis (including all maintenance) . . . for a twelve month period." The RFP also sought unit price quotations for provision of "Ion selective electrode reagent as well as all needed expendable supplies to perform analy[sis] of urine sodium and potassium," for 30,000 tests each.

Section C, DESCRIPTION/SPECS/WORK STATEMENT, referred to above, includes the following pertinent information:

> 1. The purpose of the solicitation is to establish a firm fixed price contract *for the period of one year, with option to renew for two years*, for the rental of two chemistry analyzers. The contract includes fixed prices for all supplies necessary for accomplishing the tests listed.
>
> 2. RENTAL: All associated costs for delivery, uncrating, installing, and calibrating the analyzer are to be included in the rental costs. In addition, this cost is to include all costs associated with the maintenance and repair of equipment parts (including lamps), labor and travel as follows:
>
> A. Regular preventative maintenance inspections are to be scheduled *quarterly* . . . .
>
> B. This service does not cover emergency calls necessitated by damage caused by negligence or fault of the Government, in the event of a service call under these circumstances, a separate order will

> be issued to cover the service (labor, parts, and travel time) at *prevailing rates not to exceed those charged to the general public.*
>
> * * * * *
>
> 4. Training. The successful offeror must provide initial training at this facility to the using service. Intermittent training for updated and/or changed programming will be provided on site as needed at no additional cost to the government. (emphasis added)

(R4, tab 1)

Section C, Paragraph 3, SALIENT FEATURES OF EQUIPMENT, which sets forth 14 "minimum standards" that the Analyzer was required to meet was drafted by Dr. Dear. (Tr. 17) Dr. Dear said the salient features listed for the Analyzer were "based on a system that was totally flexible . . . where the sample and reagent volumes were programmable." (Tr. 71)

On April 6, 1988, Contract Specialist Kathleen Campbell (then Kathleen Paulson) issued an amendment to the Solicitation to "[i]ncrease options to two additional one year periods." (R4, tab 3) Campbell testified that Dr. Dear had recommended extending the option periods to a total of four years and that one of the motivating factors was "to save money." (Tr. 115-16)

In a "Laboratory Service Management Briefing" report dated April 7, 1988, Dr. Tatsuo Sato, Chief, Laboratory Service at the Kansas City VAMC (Dr. Dear's immediate supervisor), stated that there was an "immediate need to acquire or lease two Perspective chemistry analyzers" which he claimed would save the medical center "$114,000 per year." He noted that a "proposal to lease *this* equipment has been approved and is now being processed by the Supply Service." (emphasis added) (Exh. G-8)

AMC salesman Dale Thomas, who had originally presented monthly lease costs to Dr. Dear in 1987 had done so based on a five year lease which he said was the "industry norm." (Tr. 205) Although he did not read the Solicitation, he said at some point the issue came up that the VA "needed the contract to go on one year increments." He discussed the matter with Marcia Striplin, Chief of Purchasing and Contracting at the Kansas City VAMC, and quoted a price for a one year lease which was "the price of equipment divided by twelve, basically." (Tr. 206) He said that Striplin told him that there was no way they could fit that one year price into their budget because the lease payments "would be five times what it would be for a five year contract." Thomas maintained that he was informed that "the five-year would be no problem, it would just be a year-to-year renewal, from what I can remember." (Tr. 207)

Although he was unclear about whether the conversations took place before or after contract award, Thomas recalled that Striplin discussed the termination for convenience clause and said "that was only in there for obsolescence of equipment." (Tr. 209) He also recalled her saying that "if the Government went broke they would not be able to fund it. It was kind of a joke, if they went broke we are all going down." Because of this, he "honestly felt there was no risk for American Monitor in this lease." (Tr. 211) Asked

whether Marcia Striplin ever guaranteed Thomas a five-year Contract, Thomas responded:

> She made it very clear to me that I had . . . to pass this on to my corporate people, that it would be a year to year contract . . . [b]ut that it would be -- it was just normal for them to [renew] it year to year. It was very common for them to go with the full five-year term.

(Tr. 209)

He relayed this information back to corporate headquarters officials who he believed "also had discussions with her." (Tr. 210) Striplin testified that she met with an AMC representative who told her that they were trying to negotiate an agreement with a finance company to finance their equipment up front because they were having cash flow problems. Striplin was informed that the finance company "had a problem with the contract because it was an option contract instead of a firm contract for five years," and because it contained a termination for convenience clause. (Tr. 406) She responded that the Government "didn't enter into contracts for more than one year at a time" and the termination for convenience clause was a "mandatory clause."

Striplin denied ever telling AMC that the contract would be a "guaranteed five year contract" and she:

> explained that the Government could enter into option contracts, that at that time we could go up to five years. The purpose was to reduce administrative costs and get better pricing if possible. That it was the unilateral option of the government for the government. And that there were different issues that had to be looked at before they were renewed. One was a market search had to be conducted or a review of the marketplace to see it was still reasonable . . . That was one of the risks, Whether the item still met the Government's needs. Whether it was thought that better pricing could be obtained if it was recomputed.

(Tr. 407)

Proposals, in response to RFP 589-32-88, were received from AMC, CIBA, Boehringer Manheim and Kodak. The four bids were reviewed according to "Evaluation Factors for Award" contained in Part IV M of the Solicitation. Under these criteria 40 points were awarded for "Technical Qualifications" and 60 points for "Cost." With respect to cost, the bidders were informed that:

> The Government will evaluate offers for award purposes by adding the total price for all options to the total price for the basic requirement. Evaluation of options will not obligate the Government to exercise the option(s).

(R4, tab 1)

AMC proposed $92,463 for the first year and a total of $463,606 if all option years were exercised. This proposal received an evaluation score of 58 of 60 possible points, just behind Kodak which scored 60 points, but ahead of the other two scores of 38 and 46. However, AMC received a perfect 40 of 40 points for technical qualifications in comparison to scores of 0, 0 and 5 for the other three bidders. Dr. Dear testified that the Eastman Kodak Company, a major competitor, "didn't have any of those" programmable and flexible features which he sought in the listed salient features. (Tr. 71)

Despite some concerns that there might be a protest alleging that "Dr. Dear was restrictive in the specifications to purposely rule out everyone but American Monitor," the Contracting Officer wrote to AMC on May 20, 1988, enclosing Contact No. V589P-1123, effective June 1, 1988, for "leasing two Perspective Analyzers . . . for a period of one year with option to renew for an additional five [sic, four] years." (Exh. G-8 at 5; R4, tab 4) AMC was informed that:

> Award has been made on the base bid. Should the government decide to exercise options, a notice of intent to exercise the option will be issued sixty days prior to the expiration of the current contract. A formal modification will then be executed.

Mark Matten, who was the Chief Financial Officer of AMC, acknowledged that he was aware that this contract was for one year with four options to renew which was "typical with most of the government deals we did." (Tr. 485) He assumed that the VA would exercise the four one year options but acknowledged that none of his colleagues at AMC ever told him that this was "a guaranteed five year contract." (Tr. 487) Asked what AMC intended to do if the VA failed to exercise one of these renewals, Matten responded:

> A. We didn't expect the VA to fail to exercise one of these renewals.
>
> Q. It wasn't a contingency you had planned for?
>
> A. Correct.
>
> Q. So would you say that it was a risk you took based on past business experience?
>
> A. Yes.

(Tr. 496)

With respect to the two Perspective Chemical Analyzer machines it was to furnish the Government, AMC entered into a "sale-leaseback" arrangement with Chesterfield Financial Corporation (Chesterfield). Under this arrangement, AMC sold the machines which it had manufactured to Chesterfield and then leased them back from the financing company for a period of five years. (Tr. 474) AMC agreed to lease the two machines from Chesterfield for $323,850 or $6,350 a month for the period July 1, 1988 to September 1, 1992. (Exh. A-13) Matten testified that the "manufacturer needs the money

from the sale of its product to build the next product coming down the line" and it "can't afford to wait five years to recoup its investment" from a lease of its equipment to a customer such as the VA. Such sale-leaseback arrangements are thus commonly utilized by equipment manufacturers to allow them to obtain needed operational funds. (Tr. 477, 493)

The first Perspective Chemical Analyzer, No. 4088, was delivered to the Kansas City VAMC and certified as "satisfactorily installed" on June 20, 1988 by Dr. Dear. (Exh. A-17) Under the delegation of authority from the Contracting Officer, Dr. Dear was designated the Contracting Officer's Technical Representative (COTR) and "authorized to furnish technical guidance and advice or generally coordinate the work performed under this contract." The Contracting Officer further informed him that he was:

> responsible for monitoring all work to assure satisfactory performance and to advise me of any problems that may arise. Deficient and/or untimely performance is to be reported to me in a timely manner . . . You are not authorized to make any commitments or changes which will affect the price, quantity, quality, or to extend the time established in the contract.

(Exh. G-10)

The second machine, No. 4092, was not certified as satisfactorily installed by Dr. Dear until July 19, 1988, and was not put "on-line" until September. (Exh. A-17; R4, tab 16 at 8)

The contract required AMC to "provide initial training at this facility to the using service." (R4, tab 1) Both the VA and AMC interpreted this clause as requiring that the Contractor train two VA employees per machine or a total of four under the contract. (Tr. 33-35, 308) Dr. Dear contemplated, as was apparently the norm in these types of leases, that the four employees trained by the Contractor would, in turn, provide training to all of the other employees in the Kansas City VAMC Laboratory Service. (Tr. 36-37) However, the parties agreed that the training would be provided at AMC's home office in Indianapolis which was their "standard practice" and intended to secure the "undivided attention of the trainee" who might otherwise be "pulled away just in the normal course of day-to-day laboratory business." (Tr. 308) Thus, VA employees Sarah Roush, Omi Meliwat, Gail Fatui and Vicky Jawarski each received a week of AMC's standard training for its customers at its headquarters in Indianapolis in June 1988. (Tr. 37, 309)

Additionally, AMC's Dale Thomas testified that it was also "normal to spend a day or two with the operators," but that "once they sign off on the installation, our deal is complete." (Tr. 219) Field Service Reports which were prepared daily by AMC field personnel, and signed by VA laboratory personnel, reveal that 32 hours of regular time and 17 hours of overtime training (travel time is included) were provided to VA personnel at Kansas City between June 13 and June 20, 1988, the date on which the VA acknowledged satisfactory installation of Analyzer No. 4088. (Exh. A-20; Tr. 271-72)

Opinions differed over the "quality" of the training the four employees received from AMC. Dale Thomas, AMC's principal contact point in its dealings with the VA, testified

that Sarah Roush told him that the "intense" training was "very thorough and it was a good training class . . . the best class that she had attended." (Tr. 189-90) However Roush recalled that she "didn't feel secure in the actual running of the instrument," because she "hadn't had enough hands-on training" in Indianapolis, "as far as actually running the instrument, making the reagents, doing the troubleshooting, doing the maintenance." (Tr. 436-37) Preventive maintenance was very important because the machine "required a great deal" of it on a daily, weekly and monthly basis. (Tr. 438-39) The "mixing of reagents" for use in the machine, posed problems because some of them "required as high as four different additives" and they often would "work one day, but not the next because of stability" problems occurring before their stated duration periods had expired. (Tr. 434-35) According to Thomas, Vicki Jawarski, one of the four trained in Indianapolis, just "didn't seem to grasp the teachings." (Tr. 190)

Whatever the quality of training, there appears to be little dispute that the intention of having the four persons trained by AMC train the rest of the staff did not go according to plan. The VA staff did not train the others immediately upon their return from Indianapolis. (Tr. 38) According to Dale Thomas, they were not immediately put to work on the Analyzers but rather:

> They all rotated into different departments in the lab other than just chemistry. And a lot of times, several of those operators were put into different departments and not given the ability to train other operators or to even operate the equipment. They were all put on a rotating work basis.

(Tr. 192-93)

These problems appear to have occurred in substantial part due to staff shortages being experienced by the Laboratory Service in Kansas City. In his "Laboratory Service Management Briefing" dated April 7, 1988, Laboratory Service Chief Dr. Sato spent considerable time detailing "major problems" occasioned by the fact that there were seven long-standing vacant positions in the laboratory which could not be filled because of a "freeze on recruitment." He noted that the laboratory had not been able to improve "turnaround time of laboratory tests" and that with the staffing shortage the problems would "not be corrected soon." (Exh. G-8) These problems apparently continued throughout the life of AMC's contract with the VA as reflected in a March 16, 1989 briefing by Dr. Sato which notes:

> Last year we had a ceiling of 68.2 full time equivalents and seven vacancies. This year we have a ceiling of 64.2 FTE and 6.9 vacancies. Each vacancy that occurs takes an inordinately long time to fill. For instance when we lost our night technologist position in September 1987 it took until December of 1988 to get this position filled . . . The staffing shortage manifests itself in overtime expenditures. Overtime has been heavily utilized in the last year to cover the vacant positions on evenings, nights and weekends . . . We lost quite a few employees directly as a result of the stress of having to rotate . . . in order to cover our laboratory 24 hours a day.

(Exh. G-7)

Roush testified that she and the other three technologists trained by AMC eventually attempted to train other VA laboratory employees and they were "partially" successful, but gave no details as to the extent of this activity. (Tr. 438) Government records which would have contained information on the extent of this training were destroyed by the VA two years after their creation in accordance with standard laboratory procedures, and thus were not available to be included in the Record. (Tr. 43-44) Based on the Record before us we conclude that any training of VA laboratory employees by the four individuals trained by AMC was minimal.

Whatever training was attempted by Roush and the other three VA employees, there is no dispute that extensive *additional* training was provided by AMC field personnel. A total of 14 VA employees received training from AMC. (Tr. 39-40) In addition to the previously noted 49 hours of training at the VAMC, just prior to the acknowledged date of satisfactory installation of Analyzer No. 4088, field training by AMC personnel continued each work day for the remainder of the month. A total of 86.5 training hours (62 regular/24.5 overtime) were provided between June 21 and June 30, 1988. Much of the overtime hours resulted from Dr. Dear's direction that training be provided to the second and third shifts who were on duty after 5:00 p.m. (Tr. 255) This pattern continued with training being provided on 13 of the 20 weekdays in July totaling 191 hours (129/62). In August, 154.5 hours (106/48.5) of additional training were provided on 15 of the 23 regular workdays. This was followed by an additional 108 hours (79.5/28.5) of training on 10 of 22 workdays in September. Finally, 54 hours (24/30) of training were provided October 18-20, 1988. (Exh. A-20)

Dale Thomas testified that at weekly meetings held to check on the progress of the installation, Dr. Dear "would make directions on what needed [to be] done to get those instruments on-line" and that the additional training provided by AMC field personnel "was directed by Dr. Dear." (Tr. 191-92) Dr. Dear denied that staff shortages were responsible for his request that AMC provide additional training. Rather, he believed that the VA employees had received inadequate training from AMC in Indianapolis. He told Thomas that:

> [T]he people were not trained adequately at their facility, that they did not have enough hands-on experience, and that therefore they would not be able to run the equipment the way it should be run until they are satisfactor[ily] trained. They had to be trained on how to operate it, how to do the preventive maintenance. Since these pieces of equipment seemed to have much more demanding upkeep and maintenance functions than a lot of equipment that we were used to, I felt they needed some additional help in training.

(Tr. 75)

Dr. Dear said that Thomas "agreed that his company would do anything it took to make those instruments functional." (Tr. 40-41) Dr. Dear insisted that he "didn't tell him to do it, I asked him if he could and he agreed." (Tr. 100) Asked whether he had told AMC that the second Perspective Analyzer would not be brought on-line until there were

"trained operators to run it," Dr. Dear responded that:

> A. Yes. Dale and I talked about that and we both agreed that there should be more -- a higher level of skill before the second instrument was brought on-line.
>
> Q. So basically American Monitor was not going to get to bring the second instrument on-line until you felt that the level of training of the fourteen people who were operating the equipment was sufficiently high to permit that to happen; is that correct?
>
> A. That is correct.

(Tr. 42)

Dale Thomas denied that he was acting as a "volunteer" in providing the services. He had "pressure to get the other Analyzer on-line," and although AMC "had supplied everything that we felt was supposed to be done," Dr. Dear had informed him that "until we got all the operators trained, he was not going to put that second unit on-line." (Tr. 195) Asked whether he had informed Dr. Dear that AMC "might request an equitable adjustment for the services" being provided, Thomas responded:

> A. No. Our compensation would have come from [the VA] buying reagents from us for five years and the long-term contract we would have had with them. We make our profit, as any company does, through the reagents. [AMC anticipated yearly profits of $73,611 from VA reagent sales. (R4, tab 33; Exh. 13)]
>
> Q. So good will was a factor?
>
> A. On American Monitor's part?
>
> Q. Yes.
>
> A. No, I would say it was more of a pressure thing to get the instruments on-line . . . I thought the pressure was severe to do the things Dr. Dear directed.

(Tr. 221-22)

Henry Ogelsby, a technical specialist for AMC who provided much of the services to the VA also said they were done at the "specific request of Dr. Dear," and that "[a]t no time did we suggest that we were going to volunteer the performance of these services . . . Dr. Dear told us that we had to do this if we wanted to maintain the equipment in the laboratory." (Tr. 304-05)

Contracting Officer (CO) Kathleen Campbell was not familiar with the contractual training requirements and acknowledged that the number of operators trained were "[t]he number of operators that the COTR recommended." (Tr. 143, 164) She was asked:

> Q. So, in essence, Dr. Dear [the COTR] determined what the training requirement was relative to who would receive training, how much people, the extent of that training, and when that training ends; is that what you are telling me?
>
> A. Yes. He is the person -- he runs that department.

(Tr. 164)

Dr. Dear confirmed that he had little input from the Contracting Officer on this project and that when he "had questions or perceived problems . . . concerning training, correlations, maintenance" he would direct those to AMC's Dale Thomas. (Tr. 45)

When the Analyzers were installed, AMC also assisted in the running of "correlation" tests comparing analytic results with three other machines currently in use at the VAMC laboratory. (Tr. 54) Such tests are customarily run to assure that the replacement equipment is reporting results consistent with the instruments to be replaced. (Tr. 85) A total of 62.7 hours (40 regular/22.7 overtime) were devoted by AMC personnel who assisted in correlation tests run on July 5 and July 18-21, 1988. (Exh. A-18) The Contracting Officer testified that during the Contract she did not know what a "correlation" test was and was unaware that AMC was providing that assistance. (Tr. 133)

Correlation tests were not required of AMC under the contract. Dr. Dear said that, generally, the VA "performed our own correlation studies without the assistance of the Contractor." (Tr. 86) But he said that AMC volunteered to assist in the correlation studies. (Tr. 52) He testified:

> They indicated to us that they had to put the correlation factors into the instruments themselves, because they were somewhat complicated to introduce. So I said fine, we will do the correlations with you, and you can be there to put in the correction factors that you think your instrument needs to correct the values that they need correcting [and] . . . That's what they did.

(Tr. 86)

Dale Thomas recollected that he brought in personnel to assist in correlation studies because Dr. Dear was not getting proper correlations and had informed him at their weekly meeting that "if he didn't get the correlations done we weren't going to put the system on-line." (Tr. 196)

A number of problems were experienced in obtaining acceptable correlation results "because some of the parts . . . didn't work right and they had to make repairs." (Tr. 87) The machine was also "temperature sensitive" making it difficult to make the Analyzer work at its "peak optimum performance" level. This posed problems because "correlation depends on both pieces of equipment . . . running at their highest or peak performance." (Tr. 87-88) Sarah Roush claimed that they did correlation studies for almost a month as opposed to a norm of from "three to five days" because:

> We couldn't get the same answers in the morning that we got in the afternoon. We couldn't refrigerate or freeze the serums one day and then get the same results the next.

(Tr. 443)

In addition to the training and correlation assistance, the Contractor also provided maintenance for the machines. As noted earlier, the Contract required AMC to provide "regular preventive maintenance . . . quarterly." These quarterly visits were to "check over the electronics and the mechanics of the instruments to make sure they are working up to their specifications." (Tr. 46) The Analyzers were sophisticated machines which required considerable other maintenance as well. The Operator's Manual set forth extensive daily, weekly and monthly maintenance procedures which were the "minimal amount of required preventative maintenance," the frequency of which was "dependent upon the laboratory's workload." (Exh. A-15)

Dr. Dear said that his employees were "attempting" to perform the maintenance set forth in the Operator's Manual but it was "[i]nitially . . . very difficult because there was too much up-keep, maintenance and reagent preparation and troubleshooting. They didn't have time." (Tr. 50) Although he denied his problems were a result of "pressure due to staffing," Dr. Dear acknowledged that his employees "weren't performing the maintenance" and as a result he "requested that [AMC] help us until we could do it on our own." (Tr. 51-53)

In this connection, AMC technician Ogelsby testified that with:

> any complex medical diagnostic piece of equipment, if the maintenance is not being done according to the manufacturer's schedule, the rate of difficulties or the occurrence of difficulties with the analyzer is going to increase. And it is going to take longer to do a preventive maintenance function once a problem has occurred, because not only do you have to do preventive maintenance but you have to correct the result of the nonperformance, than it would just to do the maintenance by itself on a proactive basis.

(Tr. 303)

Four hours of maintenance were performed by AMC technicians in July. This increased to 22 hours in August (5.5 regular/16.5 overtime) and to 36.5 in September (20.5/16). Seven hours of maintenance were performed in October and 3.9 in November. Finally, 18.8 hours of maintenance were performed in December (16.8/2) prior to the removal of the machines. (Exh. A-19) CO Campbell testified that she was unaware that the Contractor was providing this additional maintenance. (Tr. 134)

As with the provision of the additional training, recollections differed on the nature of the maintenance assistance provided by AMC. Dr. Dear said that Dale Thomas "offered" the assistance after the two had:

> talked about the problem with preventive maintenance . . . [and] he agreed that they would have people come in to help train our people and do the preventive maintenance and train them on running the instrument and troubleshooting and to actually help support, until support was no longer necessary.

(Tr. 51-52)

But Dale Thomas testified that:

> [T]he whole scope of our meetings weekly was that if we didn't get this thing on-line, you know, we are going to lose this contract . . . .
>
> Q. Did you volunteer to work free for Dr. Dear?
>
> A. Again, the issue of money never was brought up. It was always directed by Dr. Dear. It was not something that we just walked in and said, "We are going to start doing maintenance for you . . . it was more of a pressure from Dr. Dear, "You either do this or we are going to terminate the contract."

(Tr. 201)

Despite AMC's additional efforts in providing training, correlation and maintenance assistance, the VA was becoming increasingly dissatisfied with the two Analyzers it had leased. Dr. Sato, in an August 9, 1988 memorandum to the Medical Center Fiscal Service Chief, wrote that although both machines were running, "some tests are not working (i.e., LDH)" and that it was necessary to run them on "more expensive instruments." He also stated that all the technologists were still not proficient on the machines and that training was "taking much longer than we anticipated."
(Exh. G-6)

On August 22, 1988, Drs. Sato and Dear met with R. S. Waggoner, Chief of the Acquisition & Material Management Service at the Kansas City VAMC, where they outlined a number of complaints about AMC's Analyzers. According to Waggoner's memorandum of the meeting, Drs. Sato and Dear complained that the training in Indiana was "not adequate" and that AMC had not told them that the Analyzers were "very temperature sensitive" which resulted in "wast[ing] $5,000 worth of reagents." They argued that the Contractor was "responsible for costs incurred by unreasonable delays in getting this equipment operating." They agreed to compile "specific costs" and "develop strategy for making demands of the vendor." Nevertheless, Drs. Dear and Sato indicated that they were "satisfied with the Analyzers now and want to keep the equipment." Waggoner told them not to mention that to anyone other than him and the Contracting Officer since the VA wanted to keep AMC "off balance in our negotiations." (R4, tab 5)

Dr. Dear subsequently met with Marcia Striplin, Chief of Purchasing and Contracting, on September 15, where he reiterated complaints that the training was inadequate and that the equipment was not "user friendly" because it was "complex to learn and run." (R4, tab 6) Upkeep and maintenance were "extensive" and were complicated by the

fact that "[v]acancies in the Lab are making it difficult to keep up old equipment while running new." The principal complaint, however, appeared to be that actual cost per test was "double or triple" the "[i]nvestment analysis provided by the company." In view of his dissatisfaction, Dr. Dear said that AMC had indicated in recent discussions that it would "guarantee" a set price per test. Striplin informed Dr. Dear, who wanted to discuss this proposal further with Dr. Sato, that:

> [T]he options are either to terminate the contract for convenience or execute a supplemental agreement where we agree to keep the equipment in exchange for a guaranteed cost per test, as well as other possible considerations.

(R4, tab 6)

Thereafter, Drs. Dear and Sato met with CO Campbell on October 6, again complaining that they had been "mislead" by AMC concerning cost per test, daily maintenance time and the complexity of the machines. They also complained that, contrary to the Contractor's representations, the machines would only function using AMC's reagents. Asked what "remedies they would expect," Drs. Dear and Sato said that they wanted "reagent reimbursement" and *"[f]urther training on the machine"* to get costs down. (emphasis added) If AMC would not agree then Drs. Dear and Sato recommended that the Contract be terminated. A meeting with the Contractor was set for October 11. (R4, tab 7)

An inconclusive meeting followed on October 11 with an AMC representative vowing to find a prompt "solution to the problem . . . even if it meant his company taking a loss." During the week of October 17, AMC sent a serviceman to "observe the preparation of reagents . . . maintenance procedures and the general operating efficiencies of the VA." (R4, tab 12) A total of 54 hours (24 regular/30 overtime) were spent by the AMC technician on October 18-20. (Exh. A-20) According to Dr. Dear, AMC "concluded that our operating and upkeep procedures could not be improved upon." (R4, tab 12)

On November 14, Dr. Sato informed the Contracting Officer that "the instruments must be removed" because the VA had "neither the financial nor the personnel resources to support their operation." Price concessions offered by AMC were rejected since the costs "even with the discount were 17 cents [per] test instead of [the] 9 cents" per test which Dr. Dear had anticipated. (R4, tabs 10, 12) On December 2, the Contracting Officer informed AMC that the Contract was terminated for convenience effective December 31. She wrote that it was:

> not in the best budgetary interest of the Government to continue leasing this equipment. Since the start up of the instruments your company has been unable to meet the cost per test proposal on several occasions by your sales personnel. In addition, the necessary daily maintenance continues to take an excessive amount of technician time.

(R4, tab 14)

AMC sought further meetings and offered additional concessions to the VA in an unsuccessful attempt to reverse the termination decision. On December 19, the president of AMC also wrote to the Contracting Officer expressing concern about "inaccurate, exaggerated and misleading information regarding the performance of our equipment" which had "made its way outside of your institution and is causing us serious problems." (R4, tab 18) Following a telephone conversation, the Contracting Officer responded to the president that "continuing the contract was not in the best interest of the Government," but that AMC should "[b]e assured that this termination is in no way a result of your compan[y's] failure to meet the requirements of the contract." (R4, tab 19)

AMC began assembling its termination costs. In November, following review of field service reports, the company estimated that over 1,400 hours of service time had been expended on the Analyzer lease including installation time, the majority of which "could have been coded as training at the account." (Exh. A-22) Termination for convenience settlement negotiations began on December 19, 1988 and continued until September 20, 1990. (R4, tabs 18-32) AMC submitted a settlement proposal of $64,342.47 on January 4, 1990. (R4, tab 24) The Government countered with an offer of $20,000. (R4, tab 25) Ultimately, a $58,000 tentative agreement concerning the Contractor's convenience settlement proposal was reached, but not consummated, when the VA included language which would have also eliminated the Contractor's pending equitable adjustment claims for additional training, correlation and maintenance. (R4, tabs 30-32)

Thereafter, on September 5, 1991, AMC submitted certified claims totaling $772,352.12 for termination settlement expenses, for extra contractual costs and for breach of contract. (R4, tab 33) AMC sought $211,139.12 in termination settlement costs. Of this amount, $45,000 was sought for the remaining 6 months of VA's lease payments for the year. Shipping costs of $1,226.70 to deliver the Analyzers to Kansas city were claimed as well as $891.62 in freight charges to remove the machines. Another $5,307.75 was claimed for cost of training VA employees at Indianapolis. Document preparation costs of $3,696, travel expenses of $598.90 for settlement discussions in Kansas City and attorney fees in the amount of $19,000.53 for "professional consultation" were also sought.

Next, arguing that the VA had in fact "guaranteed a five year contract conditioned only on funding availability," AMC sought to recover lease expenses it had incurred in its sale-leaseback financing arrangement with Chesterfield. Observing that it had entered into a 51 month lease for the two Analyzers, AMC sought to recover its "Settlement Cost with Lessor." AMC's monthly lease payments to Chesterfield, in the amount of $6,350 multiplied by 39 months (51 months minus 12 month initial lease), resulted in a gross obligation of $247,650 to Chesterfield. The sale of the Analyzers in August 1989 produced $205,086 but was offset by $77,101.37 in "[r]efurbishment cost to restore to salable condition," leaving a net settlement cost with Chesterfield of $119,665.37. To this amount was added a claim of $16,753.15 in "lost profit on settlement cost" because the VA terminated the contract "in bad faith."

AMC also claimed $188,680 for 1,117 hours of "[e]xtracontractual training" consisting of 187 travel hours, 805.5 labor hours and 124.5 overtime labor hours. Labor and travel were billed at $160 per hour for work between the hours of 8:00 a.m. and 5:00 p.m., with an overtime rate of $240 at all other times. (R4, tab 33 at 110) For "extracontractual

maintenance" and "extracontractual correlation studies," $15,760 and $22,400 respectively, were sought using the same hourly rates listed above.

Finally, AMC claimed $331,250 in "lost profits on reagents and expendables." Estimating 624,884 tests a year at a reagent cost of $0.138 and expendable cost of $0.07 and gross profit percentages of 60% and 50%, respectively, the Contractor calculated an annual lost profit of $73,611 which multiplied by 4.5 years yielded its claim of $331,250 in lost profits resulting from the VA's "breach of contract."

In its September 5, 1991 certified claim, AMC "invite[d] negotiations" on its claims totaling $772,352.12. A final decision was ultimately rendered on June 30, 1992 when Contracting Officer Avon Hury, Assistant Chief, Acquisition and Material Management Service, denied all but $45,892 of AMC's claim. (R4, tab 38). The Contracting Officer denied that anything more than a one year contract with options had been entered into by the parties. However, the CO did allow the remaining six months of VA scheduled lease payments totaling $45,000, noting that:

> FAR 49.201(a) states "A settlement should compensate the contractor fairly for the work done and the preparations made for the terminated portions of the contract, including a reasonable allowance for profit." The contractor can show that it took steps to prepare for the terminated portion of the contract and [is] therefore entitled to this cost. This cost is arrived at by multiplying the unit price of $7,500 found in Section B of the contract, and since this unit price represents a 16% increase over the contractor's costs, it is assumed that this includes a fair profit.

The Contracting Officer denied the $1,226 freight delivery claim and the $5,307 initial training claim on the grounds that Section C of the contract provided that such costs "should be included in the rental cost." However, $892 in freight charges for removing the two Analyzers was allowed because they were "incurred as a direct result of the termination."

Document preparation costs ($3,696), travel costs for settlement discussions ($599) and attorney consultation fees ($19,000) were all denied on the grounds that the documentation did not demonstrate that the costs were incurred as part of the termination settlement process. The CO asserted that the submitted documentation indicated that many costs "appear to have been incurred as a result of pursuing a claim" before the VA Board of Contract Appeals, and thus, he denied them pursuant to FAR 31.205-47(F)1. The claim referred to by the CO involved AMC's attempted appeal of the termination for convenience which was docketed by this Board as VABCA-2946 on March 20, 1989. (R4, tab 22) Appellant subsequently withdrew its appeal as "premature" because no certified claim for costs had been submitted to the Contracting Officer. The appeal was dismissed by the Board on April 26, 1989. (R4, tab 23)

The extra contractual costs for training, maintenance and correlation studies were rejected on the grounds that there was "no evidence of any Contracting Officer authorization or direction to perform" them and that no notification was given that AMC considered such services a change to the Contract "until after termination." Finally, the

breach claim for lost profits was implicitly denied by the CO, who stated that the convenience settlement regulation (FAR 49.202) prohibits anticipatory profits. (R4, tab 38) A timely appeal of the denied claims followed. (R4, tab 39)

At the hearing on the appeals, testimony as to convenience settlement costs was received from Gerald T. Gilmartin, Comptroller and from Mark Matten, former Chief Financial Officer for AMC. (Tr. 368, 472) Invoices were identified which substantiated freight delivery costs of $1,226.70 and removal costs of $891.62. (R4, tab 33 at 43-48, 96; Tr. 370) Gilmartin testified that he spent 132 hours between February 16, 1989 and November 30, 1989 assembling, reviewing and preparing documents in connection with the termination for settlement proposal for which he charged his hourly salary rate of $28 to arrive at the $3,696 claimed. (Tr. 373-74; R4, tab 33 at 55-56) He also identified $598 in travel costs to Kansas City for himself and two other AMC officials for settlement cost discussions in March 1990. (R4, tab 33 at 57-63; Tr. 374-75)

Comptroller Gilmartin also identified a series of invoices for professional services rendered by AMC's attorneys for the period April 19, 1989 through September 27, 1990 totaling $19,000.53 (R4, tab 33 at 64-95) Gilmartin said that the invoices did not include all professional services rendered but "[o]nly those related directly [to the] T[ermination] for C[onvenience] proposal." (Tr. 376) However, examination of a $915 invoice for professional services rendered April 19-26, 1989 discloses that it was for services in connection with VABCA-2946, AMC's "premature" appeal to the Board which was dismissed for lack of jurisdiction on April 26, 1989. (R4, tab 33 at 66) Ambiguous descriptions of services rendered in invoices for subsequent periods often refer to the "termination for convenience *claim*," but Gilmartin readily agreed with the suggestion that these were "erroneous entries by the attorneys." He maintained that they actually related to the termination *proposal,* observing that AMC "never did file a claim until almost two years later." (emphasis supplied) (Tr. 376-77)

With respect to its claim for settlement costs in connection with the sale-leaseback arrangement with Chesterfield, the record discloses that AMC entered into a 51 month lease in which it agreed to pay $323,850 or $6,350 a month for the period July 1, 1988 to September 1, 1992. (Exh. A-13) At the time of termination, AMC had a remaining balance of $294,750. AMC took back the machines and refurbished them at a cost of $77,101.37. (Exh. A-39) Chief Financial Officer Matten testified that:

> A blood analyzer is not like a used car; simply bring it into the showroom and wash it and wax it and sell it as new. It's a very complex piece of electronic equipment with lots of fluids and chemicals running through it. So, in essence, you need to tear the instrument down, throw away much of the old tubing, test all of the electrical components and circuits and build the machine back up once those things are changed . . . It's a very labor intensive task.

(Tr. 479)

The equipment was then sold in August 1989 as "refurbished, remanufactured equipment to cover its cost." (Tr. 478) Analyzer No. 4092 was sold for $99,535 while

Analyzer No. 4088 was sold for $105,551. (R4, tab 33 at 101-04)

AMC presented time sheets prepared by AMC field staff and countersigned by VA Laboratory Service personnel which recorded 432.5 regular and 207.5 overtime hours of "training" provided at the Kansas City VAMC. (Exh. A-20) Similar documentation listed 40 regular and 22.7 overtime hours spent in correlation testing. (Exh. A-18) Finally, time sheets showed 55.7 regular and 34.5 overtime hours recorded for maintenance activities. (Exh. A-19) In addition to arguing that this work was either required by the contract or furnished by AMC as a "volunteer," the Government also challenged the "reasonableness" of both the charges and the time expended.

Comptroller Gilmartin testified that customers have the "option of either buying a service contract or going on parts and labor." (Tr. 380) AMC's "billing options" included either a $26,500 per year "Standard Service Contract" or a $32,800 "Extended Service Option" for service during regular hours. Service at other than regular business hours was available under either plan for an additional $2,900 or $3,200, respectively. As an alternative, AMC offered parts and labor on a per-call basis. Under this plan:

> Parts are billable at our standard list prices. Labor and portal-to-portal travel charges are billable at $160 per hour from 8:00 am to 5:00 p.m., Monday through Friday, excluding holidays . . . and $240 per hour at all other times.

(Exh. A-25)

AMC submitted billing documentation from a variety of its customers, including the Chicago (Westside) VA Medical Center, that confirmed that these were its basic commercial rates charged during the time in question. (Exhs. A-27, A-30; Tr. 380-84) Marcia Striplin asserted, however, that the Government normally does not pay commercial rates but rather "discounted rates." (Tr. 411-12) Normally, "a separate purchase order would be issued and the price negotiated" in which the Government "would try real hard not to [pay commercial rates]." Asked about the contract language which said additional services would be paid at "prevailing rates not to exceed those charged to the general public," Striplin maintained that it was a "ceiling. It didn't say we would pay that." (Tr. 415)

In addition to objecting to the rates utilized, the VA also questioned the appropriateness of the nature and/or duration of services listed in 14 separate Field Service Reports (FSRs). Attention initially centered on services provided during the first three days AMC personnel were on-site at the Kansas City VAMC. (Exh. A-20) Under the heading "Problem Description" the Field Service Reports for June 13, 16 and 17 each included the entry "Installation." As noted earlier, Analyzer No. 4088 was recorded as "Satisfactorily Installed" on June 20, 1988. (Exh. A-15) The first FSR, countersigned by Sarah Roush, indicates that AMC Representative Wanda Westphal arrived on Monday June 13, at 10:00 a.m. and departed at 9:30 p.m. An additional 2.5 hours of travel time were claimed. Summary remarks reveal that time was spent with operators labeling bottles, preparing reagents and making minor adjustments to the machine. (Exh. A-20/FSR 61009) On Thursday, June 16, AMC representative Charles Owen arrived at 7:00 a.m. and departed at 6:00 p.m. with 1 ½ hours travel time claimed. Summary remarks for

that day indicate that time was spent with Sarah Roush running the machine and apparently doing some correlation work. (Exh. A-20/FSR 56838) Owen returned the next day at 7:30 a.m. and departed at 5:00 p.m. with 1 ½ hours travel time claimed. (Exh. A-20/FSR 60810) The report indicates time spent with Omi Meliwat, also trained in Indianapolis, doing "more correlation studies" and "instructing her." Asked by Government counsel whether this training wasn't part of the normal training assistance provided at the site during initial set up, Henry Ogelsby, technical specialist for AMC, justified the charges by maintaining that "typically we [only] spen[d] two to three hours with someone when they return from Indianapolis from training." (Tr. 316)

AMC representative Wanda Westphal arrived at 7:00 a.m. on June 22, and did not depart until 7:30 p.m. The report indicates that the "operators expressed concern about going on-line too quickly," believing that they "need additional time for training and correlations." Her report says that she also spent additional "start up" training time with Omi Meliwat. (Exh. A-20/FSR 61007) Asked why Meliwat would need additional training, Ogelsby responded that "[e]vidently she was uncomfortable with doing that procedure." (Tr. 318)

The Government also questioned whether activities listed for June 23 were appropriately listed as "training." (Exh. A-20/FSR 63685) The report, countersigned by Sarah Roush, records that Westphal worked with Roush on "start up and operations," as well as on problems encountered because the software controls for the "flagging of patient samples that may require operator attention for clinical conditions" had been improperly set by the operator. (Tr. 319) Still more problems were encountered when the Laboratory's air conditioning went out, adversely affecting sample results. Questioned by Government counsel on why this should be recorded as "training," Ogelsby argued that "teaching the customer how to do the software setup" and "making sure someone understands the environmental conditions" needed for proper machine operation was "certainly . . . [a] training function." (Tr. 320-21)

The report for June 24, indicates 7½ hours "maintenance training" for Operators Fatui and Meliwat, both of whom had been trained in Indianapolis. (Exh. A-20/FSR 60816) The June 27 report, countersigned by Roush, and labeled "Training Operators" indicates an arrival time of 9:00 a.m. on June 27, and a departure at 8:00 p.m. (Exh. A-20/FSR 61011) The comments indicate that AMC field Representative Westphal "[w]orked with Sarah on operations" and doing additional software setup. (Tr. 323) Westphal was also "assisting [Roush] when she had any questions or required assistance" in performing correlations. (Tr. 323) Dr. Dear received 8 ½ hours of "basic operations" training on June 29 according to the report which Roush countersigned for AMC technician Westphal. (Exh. A-20/FSR 63663) On July 11, 1988, Westphal spent from 9:00 a.m. until 7:30 p.m. at the VAMC during which she "worked with" operators Fatui and Mailwat in the morning and with another of the Indianapolis trainees, Vicki Jawarski, in the afternoon. Jawarski countersigned this report which also indicates that training was provided to VA employee, "Gail [Fatui?]." (Exh. A-20/FSR 63690)

Questions were also raised as to why training was being provided as late as September 1. (Exh. A-20/FSR 48851) Ogelsby observed that on arriving at the site the AMC representative saw an:

error on the monitor . . . [which] usually means the instrument is low on water. Filling an instrument with water is a daily preventive maintenance function. All they did was reset the instrument and there was no problem.

> Q. In other words, all they had to do was add water; is that what you are saying?
>
> A. Yes.
>
> Q. This is in September?
>
> A. Right.
>
> Q. Why wouldn't they have known to do this by September?
>
> A. Because they weren't following our recommended daily maintenance procedures which specifically states that is something they need to do.
>
> Q. It seems very puzzling, after so many months, Can you explain that?
>
> A. Well, that is evidently one of the reasons Dr. Dear wanted us to have people available in the laboratory to provide continuing assistance on these routine functions.

(Tr. 345)

Asked who decided when an AMC technician "would go home," Ogelsby replied that he would depart "when the work that he was sent to observe was accomplished." (Tr. 257) Questions followed as to whether the prospect of overtime pay from AMC wouldn't be a "temptation . . . to run up overtime hours," Ogeslby responded that the technicians were managed by service mangers whose responsibility "was to ensue that people are using their time wisely." (Tr. 269)

AMC also sought to recover 8 hours standard and 3.5 hours overtime for training on August 1, in connection with Analyzer No. 4092. "Installation" is listed in the "Problems Description" but the form also contains "Action Code 95" which Ogelsby testified meant "training." (Exh. A-20/FSR 62797) Unlike the other Field Service Reports, there were no comments in the summary section as to what was done and there was no testimony as to what training had been provided. (Tr. 354) Ogelsby concluded, however, that this FSR could not be related to "Installation" because previously on July 19, Dr. Dear had acknowledged satisfactory installation of Analyzer No. 4092. As previously noted, however, that machine was not actually put on-line for over a month after this acknowledgment.

Finally, the Government questioned why some maintenance procedures took as long as reported in Field Service Reports. Attention was directed at seven hours of services provided on August 29, which included "monthly maintenance" on Analyzer No. 4088.

Henry Ogelsby testified that the time necessary to do maintenance depended upon the condition of the instrument, but that if the instrument were "well maintained, it could take two hours." (Tr. 281) If not well maintained, however, it could take up to seven hours. But Ogelsby also noted that the report summary indicated more than "monthly maintenance" was being performed. The Analyzer was being moved to a different site and AMC was "reinstalling the same instrument in a different place" which involved "setting it back up" and "verif[ying] everything was operating correctly."(Exh. A-19/FSR 63314; Tr. 281)

The Contractor was also asked why it took 7.5 hours on September 14, to "decontaminate the reservoir on unit 4092." (Exh. A-19/FSR 58507) Ogelsby said the source of the problem was that VA employees were "under pressure to get the workload out" and as a result mistakes occurred or preventative maintenance wasn't done according to instructions. When problems arose, the VA employees:

> rather than trying to address it themselves would go on to do other things in the laboratory. And our service staff would then go ahead and isolate whatever was occurring . . . in looking at a lot of these service records, what is obvious is we are doing the preventative maintenance but we are doing it after the problems occurred. If the preventative maintenance would have been done according to the routine schedule, it would have more than likely greatly reduced the number of problems that were seen in the laboratory.
>
> * * * * *
>
> [O]nce contamination occurs, the only way to effectively clean the reservoir is to remove it from the analyzer. You have to take it from the analyzer, flush it with a variety of compounds to ensure that whatever contamination you suspect is in the reservoir is removed. Install it back on the analyzer, refill it and recirculate water through the system.

(Tr. 290-92)

A similar problem occurred on September 20, 1988 when an "instrument halt" was experienced on Analyzer No. 4088 and six hours were devoted to locating and resolving the problem. (Exh. A-19/FSR 5821) Ogelsby testified that the reason for the halt was a "weight, which is a device which . . . helps lower vials into the water bath was dirty." Proper preventive maintenance should have avoided the problem with the "crusty weight." (Tr. 294)

DISCUSSION

VABCA-3745: Termination Settlement Costs

In a base contract award of $90,000 for a year's rental of two Perspective Chemical Analyzers, for which the VA made payments of $45,000 prior to the termination for convenience, the Contractor now seeks a total of $295,996.48 in termination costs (VABCA-3745). Appellant also claims entitlement to $147,848 in equitable adjustments

for alleged extra contractual work performed during the first six months of the contract discussed *infra* (VABCA-3914-16). A breach claim for lost profits in the amount of $331,250 has been withdrawn by AMC (VABCA-3917).

Appellant's termination cost claim, which is nearly seven times the remaining balance of the base contract rental charges, lends support to the observation that "application of the Cost Principles to termination settlement proposals is the subject of one of the most confusing portions of the Federal Acquisition Regulation (FAR)." 3 NASH & CIBINIC REPORT ¶ 70 (1989). The authors note that although the FAR provisions "indicate that Cost Principles should be clearly applicable to the settlement of termination claims," uncertainty is introduced when Part 49, TERMINATION OF CONTACTS, is consulted. FAR 49.113, **Cost principles** states, in pertinent part, that "cost principles and procedures in the applicable subpart of Part 31 shall, *subject to the general principles in 49.201*, . . . be used in asserting, negotiating, or determining costs relevant to termination settlements." (emphasis supplied) Subpart 49.2 sets forth "Additional Principles for Fixed-Price Contracts Terminated for Convenience" and provides in FAR 49.201, **General**:

> (a) A settlement should *compensate the contractor fairly for the work done and the preparations made for the terminated portions of the contract*, including a reasonable allowance for profit. Fair compensation is a matter of judgment and cannot be measured exactly. In a given case, various methods may be equally appropriate for arriving at fair compensation. The use of business judgment, as distinguished from strict accounting principles is the heart of a settlement.
>
> (b) The primary objective is to negotiate a settlement by agreement. The parties may agree upon a total amount to be paid the contractor without agreeing on or segregating the particular elements of cost or profit comprising this amount.
>
> (c) Cost and accounting data may provide guides, but are not rigid measures, for ascertaining fair compensation . . . Other types of data, criteria, or standards may furnish equally reliable guides to fair compensation. The amount of recordkeeping, reporting, and accounting related to the settlement of terminated contracts should be kept to a minimum compatible with the reasonable protection of the public interest. (emphasis added)

Considerable discretion is given to the Board in reconciling the "strict standard of allowable costs . . . and the fairness concept." ***Codex Corp. v. United States***, 226 Ct.Cl. 693, 698 (1981). See also ***Industrial Refrigeration Service Corp***., VABCA No. 2532, 91-3 BCA ¶ 24,093 at 120,594. Termination costs are one of the areas in which "accounting and related principles have been established essentially through judicial decisions." Paul M. Trueger, ACCOUNTING GUIDE FOR GOVERNMENT CONTRACTS, 10th ed. (Commerce Clearing House, 1991).

In determining what is "fair compensation" for a contract terminated prior to its natural expiration, our starting point must be what were the parties' full legal rights and

obligations if the contract had not been so terminated? We note that Termination for Convenience clause mandated by FAR 52.249-2 provides in paragraph (e) that:

> [T]he amount to be paid because of the termination . . . may include a reasonable allowance for profit on work done. However, the agreed amount, whether under this paragraph (e) or paragraph (f) below, exclusive of costs shown in paragraph f(3) below [relating to settlement costs] may not exceed the total contract price as reduced by (1) the amount of payments previously made and (2) the contract price of work not terminated.

An analysis of the contract requires us to distinguish the central core of legally enforceable provisions from the optimistic hopes and expectations that frequently surround a contractual relationship. There seems little doubt that abundant optimism surrounded the inception of the contractual relationship between AMC and the VA. While attending a trade show, Dr. Dear became enamored of AMC's Perspective Analyzer which he believed would allow not only more sophisticated chemical analysis but would also reduce unit costs for the VA. His enthusiasm apparently extended to the drafting of specifications which virtually insured that they could only be met by AMC's instrument. From its perspective, AMC entered into a one year contract with four option years apparently believing that the VA's satisfaction with the cost and operation of its machines would be so complete that the renewal options were a mere formality. According to its Chief Financial Officer, non-exercise of renewal options "simply wasn't a contingency" that AMC planned for.

Despite this pervasive optimism, the written agreement itself is considerably more clear-eyed and limited. There are no guarantees of the costs per test which Dr. Dear believed would result from the new chemical Analyzers. Nor were there contractual requirements as to the ease of use or the amount of maintenance effort required of VA personnel. Of even greater importance, while it may have been "common" or "normal" for the VA to exercise renewal options, the language is clear and unambiguous that the contract is only for one year with four additional option years which the VA is under no obligation to exercise. As the Court noted in ***Government Systems Advisors, Inc. v. United States***, 847 F.2d 811, 813 (Fed. Cir. 1988), a case with similar option language:

> The provisions and terms of the contract, read as a whole, plainly evidence the renewal of the contract as within the complete discretion of the government. An option is normally an option and nothing in [the contract provisions] limited the circumstances under which the government could decline to exercise that bargained for right in this case.

Nor has Appellant established the existence of an implied-in-fact contract in which AMC agreed to "execute binding multi-year financing in return for the Government's promise to automatically renew the Contract options." (App. Br. at 45) Appellant asks us to draw significant inferences from the fact that the VA amended its original solicitation from a one year lease with 2 option years to a one year lease with 4 option years. It also places great reliance on the somewhat vague testimony of its salesman who frankly admitted he had not read the solicitation, the provisions of which were not his bailiwick.

That a potential 5 year lease may have been an advantage to a company seeking a sale-lease back arrangement with a financing company and may have lead AMC to offer better terms to the VA does not, of itself, establish that the Government was prepared to "guarantee" it would exercise any of the options. Nor does the parties' shared hope that a productive long term relationship would develop persuade us that Government was explicitly agreeing to relinquish its inherent discretion concerning the exercise of its options. We find Marcia Striplin's testimony persuasive on this point.

As the Court noted in ***H. F. Allen Orchards v. United States***, 749 F.2d 1571, 1575 (Fed Cir 1984):

> To prove that an implied-in-fact contract exists claimants bear the burden . . . to show mutuality of intent to contract, offer and acceptance, and that the officer whose conduct is relied upon had actual authority to bind the Government in contract.

Accord, ***ABC Health Care***, VABCA No. 3462, 93-2 BCA ¶ 25, 672. Those factors are missing here. The only binding agreement the parties entered into is the one which was integrated into writing, whose terms are clear and unambiguous.

Recognition that the contract's fixed term is for one year is crucial in evaluating the fairness of Appellant's termination costs, the bulk of which emanate from the 5-year sale-lease back arrangement it entered into concerning the two machines it rented to the VA. Because it did not want to "tie-up" its capital in an equipment lease with the VA which could have extended to five years, AMC elected to sell the two Analyzers furnished to the VA to a finance company in a sale-lease back arrangement. In doing so, Appellant relied on an optimistic view of its anticipated relationship with the VA, willingly assuming a "business risk" that the Government would exercise each of the four renewal options. But the risk was precisely that the VA might not exercise the options and end its contractual relationship at the conclusion of the first year, leaving AMC with continuing lease payments to Chesterfield Financial Corporation and with an apparent need to extensively "refurbish" the machines before they could be utilized by another customer.

Had the VA completed the one year contract, its lease payment obligations would have been limited to $90,000 irrespective of AMC's continuing obligations to Chesterfield or any costs to refurbish the instruments. However, because the VA terminated the contract at the end of six months, Appellant argues that these costs now become generally recoverable under the termination cost principles. Such a claim ignores the cause of the expenses experienced by AMC. In ***American Electric, Inc.***, ASBCA No. 166635, 76-2 BCA ¶ 12,151, a case relied upon by Appellant, the Board noted that:

> [T]he overriding objective remains in essence to make the contractor financially whole for all of the *direct consequences* of the Government's exercise of its extraordinary reserved power to terminate performance, excepting the loss of anticipated profits on work not performed.
>
> * * * * *

> [S]pecial rules are provided to accommodate the unique situations which occur when a contract is terminated for the convenience of the Government . . . First is the type of cost which the contractor would have *been able to amortize against the contract price, whether through cost or profit, had he been able to complete the work and be paid the price*. Illustrative of this type of cost are . . . rental cost under unexpired leases. (emphasis added) (citations omitted)

76-2 BCA at 58,479.

We understand ***American Electric*** as well as the FAR "fairness" principle to mean that the Contractor in the appeal before us can recover certain fixed costs which he could have amortized against the remaining six months of the lease, but not against the four option years for which the Government was under no obligation to exercise. Indeed, in another case relied upon by Appellant, the DOT Board of Contract Appeals found that:

> It is not reasonable for a contractor whose contract is due to expire on March 22, 1985, to enter into a lease with a[n] expiration date some two years beyond that date, if that contractor expects the government to bear some responsibility for bearing the lease costs, absent extraordinary circumstances not shown to have been present here. It might under certain circumstances be reasonable for a contractor under a contract of this nature to lease space for a period not precisely coincident with the completion date of the contract . . . [But] the wide disparity between the March 22, 1985 expiration date of the contract and the February 28, 1987 expiration date of the lease . . . leads one to believe that [the Contractor] entered into a lease of this duration . . . [because] there would be a continued need for office space in the Los Angeles area after the initial expiration date. *In short, [the Contractor] gambled that there would be an extension of its work effort and lost.* (emphasis supplied)

TDC Management Corporation, DOTCAB No. 1802, 91-3 BCA ¶ 24,091.

Here the Appellant gambled that the VA would exercise its renewal options. That gamble failed and consequently Appellant cannot recover lease expenses covered by those periods. Nor may it recover its costs through accounting legerdemain which recharacterizes much of its expenses as "start up costs."

A different question, however, is posed by AMC's lease payments to Chesterfield for the remaining six months of the fixed term affected by the termination. Appellant could reasonably assume that fixed term lease payments due from the VA would be available to meet its lease obligations to Chesterfield. It was unable to refurbish and resell the Analyzers until August, 1989. Accordingly, we will allow $38,100 ($6,350 x 6 months) in equipment lease expenses. AMC also seeks $2,119.12 in freight and shipping costs connected with the delivery and removal of the Analyzers. The Government does not contest that these expenditures were incurred, but points out that delivery and removal were an integral part of the agreement and thus must be part of the contract price. While this argument has merit, the termination with 6 months remaining in the fixed term of the

contract prevented amortization against anticipated revenues. Accordingly, we will allow $1,059.56 which constitutes half of the expenses incurred.

Appellant also seeks a total of $16,862.39 in "Settlement Expenses." FAR 31.205-42 (g) provides, in pertinent part that:

> Settlement expenses, including the following are generally allowable:
> (i) Accounting, legal, clerical, and similar costs reasonably necessary for--
> (A) The preparation and presentation, including supporting data, of settlement claims to the contracting officer . . . .

Appellant has established $3,696 in document preparation costs and $598 in travel expenses in connection with negotiation of settlement expenses which the Government does not challenge. AMC also seeks $12,463.89 in professional consultation fees. Although we noted there was some ambiguity in the description of the services, the Government has not posed any challenge to them in its brief. Thus, with the exception of $915 in fees which we find were related to AMC's premature contract dispute claim to the Board, the professional fees are allowed in the amount of $11,548.89. Of the $16,862.39 in settlement expenses requested, $15,842.89 are allowed.

In sum, we find Appellant entitled to $55,002.45 for convenience termination costs in VABCA-3745.

VABCA-3914-3916: Training, Correlation and Maintenance Claims

In these appeals, AMC seeks $147,848 arising from constructive changes in the provision of training, correlation assistance and maintenance directed by Dr. Dear, the COTR, acting either with express or "implied actual authority." The Government tacitly concedes Dr. Dear's authority and central role in the administration of the contract, but maintains that "what he was demanding was . . . simple fulfillment of the requirements of the contract . . . [t]he Perspectives simply didn't perform as the VA had a right to expect." (Gov't Br. at 31) Although questioning the value of the assistance, the Government acknowledges that AMC field officials "frequently spent long hours in the laboratory" but argues "[t]o the degree that these activities . . . exceeded the contract's requirements the company is deemed to have volunteered their services." (Gov't Br. at 34) If any of the activities found to exceed contract requirements were not "volunteered," the Government next argues that the Contractor did not comply with 30 day notification requirement in the Changes clause and that their failure to do so was prejudicial to the interests of the VA. Finally, the VA maintains that the amounts claimed are "unreasonable" because of the "excesses found in the number of hours charged" and urges us to find that Appellant has not met "the burden of proof . . . that its costs and time spent were reasonable." (Gov't Br. at 35-36)

We turn first to VABCA-3914, the $119,000 claim for additional training, constituting the bulk of the equitable adjustments sought. It is undisputed that extensive training was ultimately provided to 14 laboratory employees under a contract which the VA conceded only required "that two technologist per machine . . . [receive] formal training." Thus, the

Government's assertion that, in requiring additional training, it was only "demanding . . . simple fulfillment of the requirements of the contract" rings hollow. Ignoring the 10 additional people trained, the Government focuses its attention on the four technologists trained pursuant to contract requirements, alleging that "[t]hey returned from classes and could not even operate the equipment." (Gov't Br. at 31)

It is undisputed that the VA employees received the standard training package provided to all AMC customers in Indianapolis. The Government has the burden of establishing that the training received was not in compliance with contract requirements. They have not met this burden. After returning from Indianapolis, Sarah Roush said she wanted more "hands-on training" because she "didn't feel secure in the actual running of the instrument." But this does not establish that the training was inadequate. It is apparent that the VA technologists encountered a sophisticated and complex machine which required higher skill levels, more activities, and closer attention to details than other equipment they were used to dealing with. It is further apparent that the reality of the Perspective Analyzers was quite different from Dr. Dear's subjective expectations. But optimistic assumptions about ease of use which are not embodied in the specifications cannot be transformed into a requirement for more training than is customarily provided under such lease contracts. Thus, with one exception, we are unable to find that the additional training provided was a contract requirement. That one exception is the initial 49 hours of training (32 regular/17 overtime) provided at Kansas City when the first Analyzer was installed and which Dale Thomas conceded was a customary part of its lease arrangements.

We next turn to whether this extra-contractual training was ordered by Dr. Dear or simply "volunteered" by the Contractor. Contracting Officer Kathleen Campbell confirmed the central role of Dr. Dear, the COTR and principal architect of the specifications, when she identified him as the "person who runs the department," and the one who "determined . . . who would receive training, how many people, the extent of training and when the training ends." Exercising this authority, Dr. Dear informed AMC that his employees "didn't have enough hands-on experience" and because the "equipment seemed to have much more demanding upkeep and maintenance . . . they need some additional help in training." He insisted that he "didn't tell [Dale Thomas] to do it, *I asked him if he could and he agreed.*" But Dr. Dear also acknowledged that he wasn't going to bring the second Analyzer on line until he was convinced that the "level of training of the fourteen people who were operating the equipment was sufficiently high to permit that to happen." AMC's Thomas said the "pressure was severe to do the things Dr. Dear directed."

The record also reflects that the VA laboratory was experiencing staff shortages at precisely the same time it was converting to the Perspective Analyzers which were more difficult to operate and which required extensive care and maintenance. Having spearheaded the change of machines at the VA, and facing the challenge of responding to the Medical Center's incessant requests for laboratory test results in a timely manner, the record discloses that Dr. Dear was not averse to exercising powers at his disposal to obtain additional assistance. This included not only the threat of reducing AMC's revenues by not putting the second machine on-line, but also the implicit, if not explicit, prospect of terminating the contract if he didn't get his way. It is difficult to detect the full and open spirit of volunteerism in such circumstances. As the Court noted in ***Gholson,***

Byars and Holmes Construction Company v. United States, 351 F.2d 987, 995-96 (Ct.Cl. 1965), it is "inherently incredible" and an "unusual situation for a contractor voluntarily to do substantially more work than is required by the terms of the contract, thus only to increase his costs." Accord, ***J. B. L. Construction Co. Inc.***, VABCA No. 1799, 86-1 BCA ¶ 18,529 (Contractor not a volunteer; constructive change found). See also ***Driftwood of Alabama***, GSBCA No. 5429, 81-2 BCA ¶ 15,169 at 75,080:

> In those instances where the Government claims that the contractor acts as a volunteer, *the evidence of charitable intent must be clear and convincing*. It must be equally clear that the Government accepted the acts with no expectation that payment might be due. Under the circumstances here, the risk of misunderstanding was upon the Government. (emphasis supplied)

See also, ***Everyready Embroidery, Inc***., ASBCA No. 6773, 67-1 BCA¶ 16,823 ("To act for self-protection is not voluntary").

Having determined that there is no clear and convincing evidence of AMC's "charitable intent" and that the additional training constituted a constructive change to the contract, we now turn to the Government's claim of "prejudice" from lack of written notice by AMC that it regarded Dr. Dear's training directives as changes. Citing ***Hoel-Steffen Construction Company***, 456 F.2d 760 (Ct.Cl. 1972), the Government acknowledges that the "case law has generally accepted even constructive notice as sufficient." But it maintains in this contract that that "contracting personnel . . . and the supervisory laboratory personnel denied ever receiving notice *of any kind* from any official from American Monitor that the work performed lay outside the requirements of the contract."

While it is true that no one from AMC said "it's going to cost you," this is not dispositive of whether the VA knew that a compensable change to the contract had been ordered. The VA's key figure, Dr. Dear, knew that only four VA employees were to be trained under specifications prepared by him, yet he "asked" AMC to train all 14 of his laboratory employees. Notwithstanding any illusions Dr. Dear may have had about AMC's "charitable intent,"(or his ability to intimidate AMC into providing extra services without charge) we cannot find that the VA did not have actual, let alone constructive notice that extra-contractual work was being performed. Indeed, each day a signed Field Service Report detailing AMC's effort and hours devoted to training was presented to the VA laboratory for counter-signature. We conclude that the Government had notice of the changed work and that it suffered no prejudice because the Contractor did not give prompt formal written notice of a claim for changed work.

Finally, we examine the Government's assertion that AMC has not met the "burden of proof that its costs and time spent were reasonable." As to costs, the record establishes that AMC's standard per-call labor rates for those clients who elected not to contract for a service plan was $160 per hour standard time and $240 overtime rate. Billing records for other federal clients, including the Chicago (Westside) VA Medical Center documented these charges were in fact billed and paid. The contract entered into between the VA and AMC provides that "service calls" will be paid at "prevailing rates not to exceed those charged the general public." AMC seeks to be reimbursed for the extra training at its

standard per hour rates.

The Government, in complaining about the hourly rate claimed, is content to simply assert that the charges are "excessive and not established by Appellant to be reasonable as required by FAR 31.201-3." (Gov't Br. at 35) Inasmuch as the record contains only information concerning the prevailing rates AMC customarily charged similarly situated customers, we cannot find them to be "unreasonable" on their face. Nor has the Government suggested any alternate method of compensating the Appellant for its extra work. Moreover, we observe that the contract itself appears to sanction such charges. Any contrary interpretation offered by the Government collides head on with the rule of *contra proferentum.*

The Government makes sweeping assertions about being charged for the "unproductive" time of AMC's "employees standing around without specific work and no supervision." But when the Government gets down to specifics it only questions 44 hours of training on seven different occasions out of a total of 640 training hours claimed. The principal objection to the 44 hours of training questioned is that it shows "the same individuals were being 'trained' over and over" and that the Field Service Reports contain only the "scantest of information" concerning the training provided. It should be observed the Government is objecting to Field Service Reports that were countersigned by VA laboratory personnel, often the very ones who were being trained. Yet no objection was registered to the comments contained in the reports. Nor was contrary evidence introduced into the record before us. (VA laboratory records concerning training, it will be recalled, were destroyed prior to the hearing on these appeals.)

That many individuals were trained more than once hardly seems surprising in light of the technologist's expressed concern for more "hands-on" training and Dr. Dear's insistence that there be a "level of training . . . sufficiently high." The frequent rotation of personnel and staff shortages were also likely contributors to the need for continued training. Whatever the value of the training, the fundamental fact is that AMC officials were responding to the wishes of Dr. Dear that they be present to assist VA personnel. Accordingly, of the 640 (432.5/207.5) training hours claimed we find the Appellant entitled to recover for all except the 49 hours of training associated with initial instrument installation. Applying the standard regular and overtime rates we award $109,800 in VABCA-3914.

In VABCA-3915, Appellant seeks $17,000 for 90.2 (55.7 regular/34.5 overtime) hours of maintenance provided during the life of the contract. Here, the record is clear that the contract required only quarterly maintenance. But Dr. Dear, facing staff shortages and having made the unpleasant discovery that the Perspective Analyzers required extensive daily, weekly and monthly care, again apparently looked to AMC to solve his problems. Our previous discussion concerning training costs is applicable here. The Government specifically questions a total of 18 hours provided on three separate occasions by AMC employees. The Government's argument, in its entirety, is that these were "long periods of time spent in alleged maintenance activities with no explanation as to why such long periods of time were necessary to perform the task or any detail as to how the time was spent." We again note that the Field Service Reports which the Government attacks are the very reports which VA Laboratory personnel signed. The record also establishes that certain maintenance activities took longer than would normally be expected because of

problems encountered by the failure of VA personnel to perform previous required maintenance. The uncontradicted technical testimony in the record is that if maintenance is not done according to schedule the "rate of difficulties with the Analyzer is going to increase" and "it's going to take longer to do a preventive maintenance function once a problem has occurred." Based on the record before us, we find the Appellant entitled to the $17,000 claimed.

Finally, in VABCA-3916, we turn to AMC's claim for $11,848 in costs incurred in 62.7 hours
of "correlation study" assistance principally rendered during the week of July 18-22, 1988. Correlation tests are quite important in assuring that the new equipment is reporting results consistent with the old instruments to be replaced. Tests assistance by AMC was not required by the contract and is typically performed by the VA without the assistance of the contractor. But AMC had a vested interest in making sure that correlation tests checked out so that the VA would feel comfortable in utilizing the new Analyzer. In this instance we find Dr. Dear's testimony persuasive that it was AMC who initiated the request to assist when they "indicated . . . that they had to put the correlation factors into the instruments themselves because they were somewhat complicated to introduce." Accordingly, we deny the appeal in VABCA-3916.

SUMMARY OF DECISIONS

VABCA-3745: Appeal granted in the amount of $55,002.45 plus interest pursuant to the Contract Disputes Act.

VABCA-3914: Appeal granted in the amount of $109,800 plus interest pursuant to the Contract Disputes Act.

VABCA-3915: Appeal granted in the amount of $17,000 plus interest pursuant to the Contract Disputes Act.

VABCA-3916: Appeal denied.

VABCA-3917: Appeal withdrawn; dismissed with prejudice.

DATE: **September 29, 1995**

GUY H. MCMICHAEL III
Chief Administrative Judge
Panel Chairman

We Concur:

JAMES K. ROBINISON
Administrative Judge

RICHARD W. KREMPASKY
Administrative Judge